Supreme Court, U.S.
FILED
DEC 5 - 2005
OFFICE OF THE CLERK

19
No. 04-1704

IN THE
SUPREME COURT OF THE UNITED STATES

DAIMLERCHRYSLER CORPORATION, ET AL.,

Petitioners,

-against-

CHARLOTTE CUNO, ET AL.,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF AMICUS CURIAE OF THE CITY OF NEW YORK IN SUPPORT OF PETITIONERS

MICHAEL A. CARDOZO,
Corporation Counsel of the
City of New York,
100 Church Street,
New York, New York 10007.
(212) 788-0848

LEONARD J. KOERNER,*
VINCENT D'ORAZIO,
ROBERT J. FIRESTONE,
of Counsel.
Counsel of Record

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INTEREST OF THE AMICUS CURIAE

The City of New York, like many state and local taxing jurisdictions throughout the United States, offers a variety of tax credits against its business taxes designed to foster private investment. Eligibility for these credits often requires a business to make capital expenditures for new facilities or to improve existing ones, and, in some instances, to maintain a minimum level of employment for a specified period at the facilities paid for with these private expenditures. The amount of the tax credit is, generally, based upon the dollar amount of the business expenditures for the new or improved facilities or equipment. The City of New York grants these credits only with respect to private expenditures made for local facilities, and does not credit investments in facilities located outside of the City of New York, in which it has no sovereign interest. The credits are not in any way based upon a taxpayer's level of local or interstate business activity, are unrelated to the amount of a taxpayer's local manufacturing or sales, and are awarded without regard to whether the taxpayer is a local or an interstate business. Behind these credits is the hope that an increase in local business investment will encourage local business activity with a concomitant improvement in the local economy and employment levels. There is not, however, a necessary link between the two, and the experience of the Federal government and many states with investment tax credits has shown that these credits do not always work to increase local business activity nor jobs. The City of New York, nevertheless, believes that these credits foster a climate conducive to business development and desires to maintain them as a less expensive means to subsidize these private expenditures, which, the City of the New York believes best serves its citizens.

Pursuant to Supreme Court Rule 37.4, the City of New York submits this brief in support of the petitioners in this

case in order to show that investment tax credits and similar credits do not violate the dormant Commerce Clause of the United States Constitution, which prohibits only those regulatory and taxing measures that operate like a tariff.

SUMMARY OF THE ARGUMENT

This Court has consistently confined the scope of the Commerce Clause in its negative aspect to regulatory and taxing measures which have the effect of a tariff, "that is, no State may discriminatorily tax the products manufactured or the business operations performed in any other State." *See, e.g., Westinghouse Electric Corp. v. Tully et al.*, 466 U.S. 388, 407 n.12 (1984). As will be shown, *infra*, the Court has consistently described tariff-like taxing measures as those which, either, discriminatorily tax the interstate import or export of goods or services, or discriminatorily tax the performance of business activities, such as manufacturing, sales or services, on the basis of some interstate element.

An investment tax credit, one tied to the dollar amount of investment in in-state property, is not a tariff-like measure. Although such an investment helps to encourage increased local business activity, the credit bears no necessary relation to the manufacturing or services performed, neither, locally nor in interstate commerce. Therefore, unless a statute further confines the credit to the dollar volume of such activity, or to the dollar amount of interstate sales, it does not "discriminatorily tax the products manufactured or the business operations performed in any other State." Precisely for this reason the Court has essentially stated, *in dicta*, that investment tax credits and job incentive credits do not violate the dormant Clause, distinguishing them from those credits "allowed on an impermissible basis." *Westinghouse, supra*, at 407 n.12. A contrary conclusion would require a state to pay a portion of the cost of property invested in states in which it has no sovereign interest and, thus, directly subsidize, not

the business activity conducted there, but the seeds for that state's future economic development. The Constitution, least of all the dormant Commerce Clause, does not require such a result.

In determining whether a tax credit, in its effect, discriminates against interstate commerce, this Court considers whether the credit evenhandedly apportions to the taxing jurisdiction the instate and out-of-state manufacturing, sales or other business activity. *See, e.g., Armco v. Hardesty,* 467 U.S. 638, at 644-645 (1984) ("A tax that unfairly apportions income from other states is a form of discrimination against interstate commerce.") Where the effect of a credit is to tax out-of-state manufacturing, services or sales at a higher effective rate than similarly situated instate activity, such a credit has been held to be discriminatory because it inversely apportions the out-of-state activity to the taxing jurisdiction. *See, e.g., Fulton v. Faulkner,* 516 U.S. 325, 327 (1996) (prohibition against inverse apportionment). Investment tax credits, which are awarded without regard to where the manufacturing or other business activity is performed, and without regard to the origin, destination or place of sale, do not discriminate against interstate business activity and, therefore, are not equivalent to tariffs in their effect.

Additional reasons militate against treating Ohio's investment tax credit as equivalent to a tariff. Under Ohio's business income apportionment scheme, which includes a property factor among its three apportionment factors as a proxy for business activity, a taxpayer who invests in Ohio property eligible for the credit is not similarly situated to a taxpayer who invests in property located outside of Ohio. The former receives a credit based upon the same investment in property that increases its instate apportionment percentage. The latter is denied the credit, but also decreases its taxable presence under the state's property factor by investing in such property outside

of the state. As the two taxpayers are not similarly situated in relation to Ohio's taxing scheme, there can be no forbidden discrimination in such a case.

The Sixth Circuit's decision, which invalidated Ohio's investment tax credit on the grounds that it encourages instate investment and the development of local business at the expense of other states, misapplies this Court's dormant Commerce Clause jurisprudence in several respects. Under the Court's "internal consistency" test, a sister state having a sovereign interest in the investment would be deemed to have enacted the identical taxing scheme and, therefore, would be deemed to provide the identical credit, resulting in no mal-apportionment nor discrimination. The Sixth Circuit's holding is incompatible with the internal consistency requirement, because it produces multiple credits for a single instate investment, and places interstate commerce at a tremendous advantage over wholly intrastate commerce. Although there are legitimate policy questions regarding the efficacy of investment credits, Congress is best-suited to resolve these under its affirmative Commerce Clause authority. The Sixth Circuit's decision extends the dormant Commerce Clause well beyond its present function, to protect interstate markets against discrimination, substituting a new standard which forbids states from enacting non-discriminatory tax laws encouraging local investment unless those laws also subsidize the economic development of all other states. The decision, therefore, should be reversed.

ARGUMENT

I. INVESTMENT TAX CREDITS ARE NOT EQUIVALENT TO TARIFFS UNDER THE COURT'S DORMANT COMMERCE CLAUSE JURISPRUDENCE, WHICH PROHIBITS BARRIERS AGAINST INTERSTATE TRADE AND DISCRIMINATION AGAINST INTERSTATE MARKETS, BUT DOES NOT REQUIRE A STATE TO SUBSIDIZE, THROUGH ITS TAX LAWS, THE PRIVATE INVESTMENT IN, AND THE ECONOMIC DEVELOPMENT OF OTHER STATES.

The Commerce Clause, which provides that "the Congress shall have Power ... to regulate Commerce with Foreign Nations, and among the several States," vests Congress with plenary authority to regulate interstate Commerce. *Gibbons v. Ogden,* 22 U.S. 1, at 193, 196 (1824); *Southern Pacific Co. v. Arizona,* 325 U.S. 761, 769 (1945). The explicit grant of authority pursuant to this Clause is broad, and gives Congress the power to regulate virtually every activity that exerts an influence on interstate Commerce. *Wickard v. Filburn,* 31 U.S. 111 (1942); *Heart of Atlanta Motel v. United States,* 379 U.S. 241 (1964); *Katzenbach v. McClung,* 379 U.S. 294 (1964). The Court has also recognized that the 10th Amendment reserves to each state the limited authority to regulate interstate commerce in the course of exercising its police and taxing powers, but only to the extent that each state's interest is sufficiently local in nature so as not to interfere with Congress' explicit authority. *Cooley v. Board of Wardens,* 53 U.S. 299 (1851) (10th Amendment reserves to the states the power to regulate interstate commerce so long as the effect is sufficiently local in nature so as not to require a uniform national rule).

The "negative" or "dormant" Commerce Clause, thus, appears nowhere in the text of the Constitution, but has been construed by the Court as a necessary implication

of the delicate balance the Commerce Clause strikes between the Constitution's broad grant of authority to Congress to regulate the national economy and the states' retention of their police and taxing powers, even where the exercise of those powers affects interstate commerce. The dormant Commerce Clause achieves this balance by assuring that states do not impede interstate commerce beyond their local interests and, in effect, step into Congress's role of regulating the national economy. *Pike v. Bruce Church Inc.*, 397 U.S. 137, 142 (1970) (where the Court balanced local against Federal interests in striking down a local regulation); *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977) (where the Court prescribed a four-part test to balance those interests under taxing statutes).

Given the limited purpose of the dormant Commerce Clause, and the Court's reluctance to involve itself in matters properly within Congress's domain, the Court has carefully confined the dormant Commerce Clause to serve one function. It "prohibits economic protectionism – that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 192 (1994) (import tariff on milk). The dormant Commerce Clause comes into play only where a state tax or regulation either discriminates against interstate markets or unduly burdens competition in those markets tantamount to discrimination. The dormant Commerce Clause protects individual taxpayers and the economies of other states against a state tax or regulation only insofar as the tax or regulation discriminates against the flow of goods and services in interstate markets because "the dormant Commerce Clause protects markets and participants in markets, not taxpayers as such." *General Motors v. Tracy*, 519 U.S. 278, 300 (1997). *See also, City of Philadelphia v. New Jersey*, 437 U.S. 617 (1978) (statute banning other states from using local landfills discriminated against the flow of commerce across state lines).

It will be shown, *infra*, that this Court has construed the dormant Commerce Clause as prohibiting taxes that have the effect of a tariff, discriminating against goods and services in interstate markets. The Court has never held a tax discriminated against interstate commerce except when it amounted to a tariff. The Sixth Circuit decision, holding invalid a tax credit which applied without regard to where goods or services were produced, marketed or sold, thus, significantly expands the dormant Commerce Clause beyond its present scope.

A. The Court has carefully confined the scope of the dormant Commerce Clause to tariff-like measures, those which discriminate against goods and services in interstate markets. The Sixth Circuit's decision expands the dormant Commerce Clause and is incompatible with this body of case law.

This Court has invoked the dormant Commerce Clause only to protect, against discrimination, interstate business transactions and the interstate business operations incident to those transactions. "[A] State may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State.'" *Camps Newfound v. Town/ Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 581 (1997). The applicability of the dormant Commerce Clause has, thus, been limited to discriminatory measures that penalize business activities when those activities cross state lines. Since these measures amount to import and export tariffs in their end result, the Court has described tariffs as "the paradigmatic example of a law discriminating against interstate commerce." *West Lynn Creamery, supra*, at 193.

A review of each of the Court's modern dormant Commerce Clause decisions invalidating state taxes demonstrates that each tax was, in reality, a tariff on interstate sales, manufacturing, or services. *See, e.g., Boston Stock Exchange v. State Tax Comm'n*, 429 U.S.

318, 331-332 (1977) (tariff on interstate stock transfers); *Maryland v. Louisiana*, 451 U.S. 725 (1981) (import tariff on natural gas); *Armco, supra* (import tariff on out-of-state manufacturing); *Westinghouse Electric, supra* (tariff on out-of-state export shipments); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) (import tariff on liquors); *Tyler Pipe Industries, Inc. v. Washington*, 483 U.S. 232 (1987) (export tariff on instate manufacturing); *New Energy Company of Indiana v. Limbach*, 486 U.S. 269 (1988) (import tariff on ethanol production); *West Lynn Creamery, supra* (import tariff on milk); *Fulton, supra* (tariff on doing an interstate business); *Camps Newfound, supra*, at 580-81 (export tariff on services).

Each of the above tariffs benefited instate economic interests such as local stock exchanges, manufacturers, sellers, exporters and consumers by imposing a higher effective tax rate on their out-of-state competitors. The dormant Commerce Clause applies only where a taxing measure impedes the flow of commerce across state lines, adversely impacting competition in the interstate markets for those goods and services. "This negative command prevents a State from ...placing burdens on the flow of commerce across its borders that commerce wholly within its borders would not bear." *American Trucking Associations, Inc. v. Michigan Public Service Commission*, 125 S. Ct. 2419, 2423 (2005).

In one of its more recent dormant Commerce Clause decisions the Court highlighted some of the adverse effects of tariffs on the national economy, employing language that, when taken out-of context, might erroneously suggest that the Court would apply the dormant Commerce Clause to state taxes that do not amount to tariffs. In *West Lynn Creamery, supra*, the Court invalidated, under the dormant Commerce Clause, a tax on all milk production coupled with a rebate of the tax only to local milk producers, the effect of which discriminated against the import of out-of-state milk. The *West Lynn Creamery* Court noted that one

negative consequence of the Massachusetts scheme was that it "artificially encourages in-state production even when the same goods could be produced at lower cost in other States." *Id.*, 512 U.S., at 193. While this, and several similar statements in the Court's opinion, summarized *at* 207-208 (Scalia, J., concurring in the judgment), were illustrative of some of the adverse effects of such a scheme on the national economy, these statements were not the holding of the case. The Court invalidated the Massachusetts scheme solely on the grounds that it operated as an import tariff on milk: "Like an ordinary tariff, the tax is thus effectively imposed only on out-of-state products." *Id.*, at 194.

West Lynn Creamery, therefore, cannot be plausibly read to hold that a taxing statute which "artificially encourages in-state production even when the same goods could be produced at lower cost in other States" is invalid, regardless of whether it operates as a tariff. The Court began its statement of the applicable law by presupposing that the Massachusetts scheme was a tariff, explaining that a tariff is "[t]he paradigmatic example of a law discriminating against interstate commerce." *Id.*, at 193.

The Commerce Clause does not, by its own force, prohibit a tax credit that "artificially encourages in-state production" at the expense of out-of-state production. *Westinghouse Electric, supra,* 466 U.S., at 407 n.12:

> We reiterate that it is not the provision of the credit that offends the Commerce Clause, but the fact that it is allowed on an impermissible basis ... We do not 'hold that a State may not compete with other States for a share of the interstate commerce; such competition lies at the heart of a free trade policy. We hold only that in the process of such competition no State may discriminatorily tax the products manufactured or the business operations

> performed in any other State.' [*Quoting Boston Stock Exchange, supra.*]

Ohio's investment tax credit, like similar credits enacted by many states to attract business capital investment, does not "discriminatorily tax the products manufactured or the business operations performed in any other State." It is awarded without regard to where the goods are produced, *see Armco, supra, New Energy, supra,* shipped, *see Westinghouse Electric, supra,* or sold, *see Tyler Pipe, supra,* and without regard to where any of the taxpayer's business operations incident to the production or sale of those goods are performed, *see Fulton, supra.*

The tax credits invalidated in *Armco, Tyler, and Fulton* each followed the same pattern, crediting a tax imposed on a strictly local activity against a tax imposed on a different activity conducted in interstate commerce. *Armco, supra* (manufacturing tax credited against wholesale tax resulted in tariff on out-of-state manufacturers). *See also, New Energy, supra* (invalidating a credit against the sales tax for the instate production of ethanol); *Westinghouse Electric, supra* (discriminatory credit limited to exports shipped from within the state).

The investment tax credit does not credit one tax against another tax, as in *Armco, Tyler, and Fulton*, and is not a credit for the performance of a local activity, as in *New Energy* and *Westinghouse Electric.* Instead, it is a credit for a private investment. The state legislature, in effect, determines that some or all of a taxpayer's out-of-pocket expenditure for an instate private investment serves a public purpose, erecting local property that, it is hoped, will provide jobs and a future tax revenue stream. The state's legislature, however, has no comparable sovereign interest in paying the cost of a private investment in property located in another state. It would be nothing short of waste for the state's legislature to credit a private expenditure for a capital investment located in another state that does nothing to advance the public interest of its own

state. While it is within the province of that other state's legislature to choose to credit the cost of the property against its own tax in order to further its own economic development, the dormant Commerce Clause does not mandate that where a state chooses to use its tax laws to pay the cost of an instate investment, it must then finance the economic development of the other 49 states.

The *Fulton* Court, thus, explained that because a state has no "sovereign interest" in taxing the income derived from business conducted in another state, it cannot justify a discriminatory property tax on corporate stock that increases to the extent that the corporate issuer does business outside of the state under the rationale that, by doing so, the corporation pays a reduced corporate income tax. *Fulton, supra,* at 334. Because a state has no sovereign interest in a corporation's out-of-state business activities, the state is not entitled to be compensated for its inability to tax those activities.

By the same reasoning, Ohio has no sovereign interest in paying the cost of private investments in property located in other states. While the legislatures of those other states can conceivably decide that private expenditures to erect new property located in their respective jurisdictions advance the public interest by providing local employment and tax revenues, the choice of whether or not to credit the cost of that property against state taxes vests exclusively in those other state legislatures having a sovereign interest in the property. For Ohio to credit the cost of an investment in out-of-state property against its taxes would be nothing short of wasting public funds, as its legislature has no sovereign interest in paying the cost of an investment in property located in another state. *cf. Brett Abbott v. City of Parma,* 112 Ohio App.3d 570, 574-575 (Ct. of Appeals Ohio, 8th Appellate Dist. 1996) (waste of public funds only where expenditure bears no rational relation to a public purpose). The state in which the property is located provides the requisite "protection,

opportunities, and benefits," *see Wisconsin v. J.C. Penney*, 311 U.S. 435, 444 (1940) to justify taxing it, and that same sovereign interest in the property justifies that state to credit its cost against the state's business taxes so as to encourage such an investment and the potential local economic benefits that might flow from the development of the property.

Where a state attempts to tax an activity over which it has no sovereign interest, such as out-of-state manufacturing, out-of-state sales or out-of-state services, the state tax violates the requirement that it must be "fairly apportioned" to the taxing jurisdiction. *Armco, supra, at* 644-645. In *Complete Auto, supra,* this Court held that a state tax comports with the dormant Commerce Clause where it (1) is applied to an activity with a substantial nexus to the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the state. For a state tax to be "fairly apportioned" to the taxing state, it must be, both, "externally consistent" and "internally consistent." *Container Corporation of America v. Franchise Tax Board,* 463 U.S. 159, 169 (1983). A state income tax apportionment scheme is "externally consistent," where it "actually reflect[s] a reasonable sense of how income is generated." *Id.* The external consistency test is, for the most part, delineated by the requirements of due process and, as such, requires no more than a rational relationship between the amount of the tax and the net income economically earned within the taxing state. *Moorman Manufacturing C. v. Blair,* 347 U.S. 267, 274 (1978) (taxpayers must prove, by "clear and cogent evidence" that a state apportionment scheme is "inherently arbitrary"). Ohio's investment tax credit does not result in the apportionment to Ohio of income economically earned in other states. Ohio, like many states, uses a three-factor formula to apportion income within and without the taxing jurisdiction. The investment tax credit does not affect that formula, and does not otherwise cause Ohio's tax to

overreach beyond its jurisdiction to tax the income earned in other states. Therefore, Ohio's investment tax credit does not violate "external consistency." To the extent that Ohio's investment tax credit interacts with the property factor of Ohio's three-factor apportionment formula, it will be addressed, *infra*, in Sub-Point B.

Ohio's investment tax credit also comports with the "internal consistency" requirement of "fair apportionment." *Container Corp., supra*, at 169. A taxing scheme is internally consistent where the application of the identical scheme by every state does not result in multiple taxation. *Oklahoma v. Jefferson Lines, Inc.*, 514 U.S. 175, 185 (1995). For example, *Armco, supra*, held that West Virginia's credit against its wholesale tax limited to instate manufacturing violated the internal consistency requirement. Under that scheme, out-of-state manufacturers were subject to two taxes, a manufacturing and a wholesale tax, while instate manufacturers paid only a manufacturing tax. *Id.*, at 644. The tax violated the internal consistency requirement by subjecting products manufactured in Ohio and sold in West Virginia to multiple taxation not born by products manufactured and sold in West Virginia. *Armco*, at 644-645: "A tax that unfairly apportions income from other States is a form of discrimination against interstate commerce."

The investment tax credit does not violate the internal consistency requirement for fair apportionment. In fact, the Sixth Circuit's reasoning that if Ohio grants a credit for the cost of an instate investment it must then credit the cost of investments made in the other 49 states, is incompatible with, and diametrically opposed to, the rationale underlying this Court's internal consistency jurisprudence. Where a state denies a tax credit on the basis of an interstate activity over which the state has no sovereign interest, it violates the internal consistency requirement because of the effect of taxing out-of-state

activity more heavily than instate activity. *Armco, Tyler, Fulton.*

A necessary corollary to the requirement that a state must have a sovereign interest in an activity in order to tax it, is that a state is not required to pay the cost of investments in other states in property in which it has no sovereign interest. This corollary derives directly from the internal consistency requirement. If the other state in which the property investment is made adopts the "identical" scheme as Ohio's, *see Jefferson Lines, supra,* it will also offer an investment tax credit. The internal consistency requirement would, thus, be satisfied, the tax "fairly apportioned" with no discrimination. *Armco, supra,* at 644-645. More significantly, the internal consistency requirement would properly assign the responsibility for granting the investment tax credit to the state having a sovereign interest in paying the cost of the investment to further its own economic development. The analytical framework supporting such a conclusion also forecloses an interpretation of the dormant Commerce Clause that forces a state legislature to waste taxpayers' funds by paying for the erection of property located in other states, for the sole reason that it chooses to limit its expenditures to projects that benefit its own citizenry.

Furthermore, when the investment tax credit is viewed from the perspective of the internal consistency requirement, with its focus limited to the question "What if every state repeated this identical taxing scheme?", it becomes apparent that a taxpayer should be entitled to only one such credit for its instate investment. Although the purpose of the internal consistency requirement is to avoid multiple taxation, its logic, consistently applied, extends also to multiple credits. Thus, if Ohio and State A are presumed to have the identical corporate income tax scheme, it would be illogical for a taxpayer to expect to receive an investment tax credit for investing in Ohio property from, both, Ohio and State A. However, that is

precisely the result mandated by the Sixth Circuit's decision – if State A grants taxpayers a credit for the cost of new plant constructed in State A, it must also grant a credit for the new plant constructed in Ohio, or violate the dormant Commerce Clause. Under the "cloning" of tax statutes inherent in the internal consistency test, *Jefferson Lines, supra*, both Ohio and State A would be presumed to offer a credit for the investment in Ohio property, resulting in multiple credits for the same investment. In fact, the internal consistency test would presume that a taxpayer doing business in 50 states would receive 50 investment tax credits for that single investment in Ohio property.

Were this Court to read such a requirement into the dormant Commerce Clause, it would place interstate commerce at a tremendous advantage over wholly intrastate commerce (because a taxpayer doing business only in State A would be entitled to only one credit for its investment in property located in State A). However, as this Court has repeatedly held: "it was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business." *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 623-624 (1981), quoting *Western Live Stock v. Bureau of Revenue*, 303 U.S., at 254. The internal consistency requirement, thus, brings into clear view the inappropriate twist to this Court's dormant Commerce Clause jurisprudence that would result from adopting respondents' position in this case.

Although this Court has consistently held that a state tax discriminates against interstate commerce only where it has the effect of a tariff, the Sixth Circuit has rejected such a limitation on the scope of the dormant Commerce Clause. *Cuno*, 386 F.3d, at 745. In summarizing petitioners' position the Sixth Circuit accurately summarized this Court's decisions:

> According to their [petitioners'] theory, the only tax credits and exemptions that would run afoul of the Commerce Clause fall into two categories: those that function like a tariff by placing a higher tax upon out-of-state business or products and those that penalize out-of-state economic activity by relying on both the taxpayer's in-state and out-of-state activities to determine the taxpayer's effective tax rate.

The Sixth Circuit, however, rejected such a limitation on the dormant Commerce Clause:

> Although it is possible to fit certain of the Supreme Court's cases into this framework, it is clear that the Court itself has not adopted this approach in analyzing dormant Commerce Clause cases, undoubtedly because it rests on the distinction between laws that benefit in-state activity and laws that burden out-of-state activity.

Id.

The Sixth Circuit provides no authority in support of its conclusion that the dormant Commerce Clause would hold a state tax to be discriminatory even where it does not amount to a tariff. Both of the cases on which the Sixth Circuit relies, *Bacchus Imports, supra,* and *Westinghouse Electric, supra,* involved tariffs.

The Hawaii liquor tax invalidated in *Bacchus Imports* was a classic tariff, providing an exemption only for a locally-produced brand of wine, while taxing wine imported from other states at the full tax rate. The Court expressly identified Hawaii's tax as a form of "economic protectionism", 468 U.S., at 270, "because it had both the purpose and effect of discriminating in favor of local products." *Id.*, at 273. Hawaii's liquor tax was, thus, held

to violate the dormant Commerce Clause, because "in the process of competition no State may discriminatorily tax the products manufactured or the business operations performed in any other State." (Internal quotes omitted.) *Id.*, at 272.

Similarly, in *Westinghouse Electric*, the Court held New York's DISC Export Credit facially discriminated against exports shipped from other states in favor of exports shipped from New York, *Id.*, at 400, violating the cardinal rule that "in the process of competition no State may discriminatorily tax the products manufactured or the business operations performed in any other State." *Id.*, at 406 n. 12.

More significantly, the validity of Ohio's tax credit does not turn on the sophistic distinction "between laws that benefit in-state activity and laws that burden out-of-state activity." *Cuno*, 386 F.3d, at 745. Rather, Ohio's credit is not awarded on the basis of where goods are produced, marketed or sold, or based upon the location of the performance of any business operation ancillary to the flow of goods in interstate commerce. In short, it does not have the effect of a tariff because it does not "discriminatorily tax the products manufactured or the business operations performed in any other State." *Westinghouse Electric*, *supra*. For Ohio's investment tax credit to be held to discriminate against interstate commerce, it must do more than merely advance the economic development of Ohio without comparably advancing other state's economies. It must discriminatorily tax the flow of goods in interstate commerce on the basis of some interstate element. *Fulton*, *supra*, 516 U.S., at 331: "a State may not discriminate between transactions on the basis of some interstate element" [internal quotes omitted].

Consistent with this body of decisional law holding that a state tax discriminates against interstate commerce only where it has the effect of a tariff, this Court has essentially stated, in *dicta*, that investment tax credits and

job incentive credits do not violate the dormant Commerce Clause because they are not "allowed on an impermissible basis." *Westinghouse Electric, supra,* 466 U.S. 388, 407 n.12 (1984):

> The Tax Commission seeks to classify the tax credit at issue here as ... similar to ... *enactment of job-incentive credits and investment tax credits* ... We reiterate that it is not the provision of the credit that offends the Commerce Clause, but the fact that it is allowed on an impermissible basis, i.e., the percentage of a specific segment of a corporation's business that is conducted in New York ... [Emphasis added.]

The Court's *dicta* provided guidance to states concerning the scope of its decision, explaining that not all tax credits that encourage economic development are prohibited by the dormant Commerce Clause, only protectionist measures that award tax credits on the basis of the amount of business a taxpayer conducts locally as compared with the amount that taxpayer conducts in interstate commerce. The *dicta* regarding investment tax credits and job incentive credits would have had little value in providing guidance to States concerning the validity of their existing programs if it could be read to mean that "job-incentive credits and investment tax credits," as those terms were commonly understood at the time, by their very nature discriminate against interstate commerce. Rather, the clear implication of the *dicta* is that such credits do not generally violate the dormant Commerce Clause, and will be invalid only where a statute further limits such credits based on the amount of business activity, such as manufacturing, sales, marketing, shipping, etc., the taxpayer performs within the state.

The clear implication of *Westinghouse Electric,* therefore, is that "job-incentive credits and investment tax credits" do not offend the Commerce Clause because they

are not "allowed on an impermissible basis." The Sixth Circuit disregarded the holding in *Westinghouse Electric* that New York's credit was invalid because it discriminated against business transactions on the basis of an interstate element, i.e., because it had the effect of a tariff.

It is undisputed that a tax that benefits intrastate business transactions but does not provide the same benefit to interstate business transactions discriminates against interstate commerce. The form of the discrimination against interstate commerce is irrelevant. The inquiry is limited to whether the state tax or regulation favors intrastate goods or services over interstate goods or services. It does not matter whether the tariff favors instate manufacturers over their out-of-state competitors, *Armco, supra, New Energy, supra*, instate consumers of goods over the out-of-state market for those same goods, *Tyler Pipe, supra*, or instate consumers of services over the export market for those same services, *Camps Newfound, supra.* A protectionist statute violates the dormant Commerce Clause regardless of the means it uses to accomplish its end.

Ohio's investment tax credit draws no distinction between goods and services marketed in interstate commerce, and those marketed in intrastate commerce. A taxpayer who erects a plant outside of Ohio will be denied a credit for the cost of that plant against its Ohio taxes regardless of whether the goods produced by that plant are sold in interstate commerce, are sold strictly in intrastate commerce, or are produced for self-consumption. The credit, moreover, bears no relation to the amount of goods produced at a plant receiving the credit, or whether any of the goods produced there are actually sold. In sum, Ohio's credit bears no relation to the amount of business, or the percentage of the total business, conducted by a taxpayer at any location. *Compare Westinghouse Electric, supra.*

The rationale underlying the Sixth Circuit's holding that Ohio's investment tax credit discriminates against

interstate commerce, does not take into account the effect of the credit on interstate markets nor on competition in those markets. Instead, it focuses on the individual corporate taxpayer, and that taxpayer's tax situation if it invests in Ohio property or in property located in another state. *Cuno, supra,* 386 F.3d, at 743: "Specifically, any corporation currently doing business in Ohio, and therefore paying the state's corporate franchise tax in Ohio, can reduce its existing tax liability by locating significant new machinery and equipment within the state, but it will receive no such reduction in tax liability if it locates a comparable plant and equipment elsewhere."

The Sixth Circuit's comparison between an individual taxpayer choosing to invest within and without Ohio is incorrect as a matter of law. The relevant comparison under the dormant Commerce Clause is between an instate business (or consumer) and its out-of-state competitor: "the dormant Commerce Clause protects markets and participants in markets, not taxpayers as such." *General Motors v. Tracy, supra,* 519 U.S. 278, 300 (1997). The Court will not inquire into "the extent of such competition" in the market, but will limit its inquiry to whether there is at least some competition between the locally produced product and an out-of-state product. *Bacchus Imports, supra,* 468 U.S., at 269.

The Sixth Circuit's comparison between one and the same taxpayer, instead of between competitors in the marketplace, therefore, is irrelevant to the issue of whether Ohio's investment tax credit is a tariff. The decision, however, also notes, *Cuno, supra,* at 743: "Moreover, as between two businesses, otherwise similarly situated and each subject to Ohio taxation, the business that chooses to expand its local presence will enjoy a reduced tax burden, based directly on its new investment, while a competitor that invests out-of-state will face a comparatively higher tax burden because it will be ineligible for any credit against its Ohio tax."

The Sixth Circuit's reference to "competitor" is misleading, however, because it addresses an issue that is not presented by Ohio's investment tax credit, which is allowed without regard to where goods or services are produced, marketed or sold. Ohio's investment tax credit is denied to any investment in property located outside of Ohio, even if it ultimately produces goods sold in purely intrastate commerce or for self-consumption. Since Ohio's tax credit does not discriminate against "markets or participants in markets," *Tracy, supra,* the Sixth Circuit's inquiry into the comparative tax consequences to an individual corporate taxpayer is the wrong comparison as a matter of law.

There is no dispute that the use of investment tax credits (and similar credits for the costs of instate business investment) raise legitimate policy questions concerning the extent to which states should use their taxes to compete, within the confines of the dormant Commerce Clause, for a share of interstate business. Investment tax credits, however, are not the sole means by which states legitimately use their tax laws to encourage instate investment and, thus, enter the fray of competing with other states for a share of jobs and capital. Some states have switched their franchise tax apportionment formulas from the traditional three-factor formula to a single-factor sales formula, the effect of which is to encourage taxpayers to shift the location of their investments in property and wages from states that employ the three-factor formula. *See Moorman, supra,* 347 U.S. 267 (1978). Nevertheless, in spite of the competition for jobs and capital fostered by single-factor sales formulas, this Court has held that such apportionment formulas do not discriminate against interstate commerce, and has refused to extend its inquiry under the dormant Commerce Clause beyond the question of discrimination when considering the constitutionality of such formulas. *Moorman, supra.* Congress, pursuant to its affirmative Commerce Clause authority, is the proper forum to resolve these legitimate questions of policy.

The Court does not construe its authority under the dormant Commerce Clause as co-extensive with Congress' affirmative grant of authority. Although the Court in *Camps Newfound, supra,* 520 U.S. 564, 574 (1997), stated that "[t]he definition of 'commerce' is the same when relied on to strike down or restrict state legislation as when relied on to support some exertion of federal control or regulation ...", the Court's statement must be read in its proper context. In that case the Court invalidated a property tax that discriminated against the sale of camp services to out-of-state consumers. The state had argued that a property tax is strictly a local matter and not subject to Commerce Clause scrutiny. In rejecting that argument, the Court made clear that its focus was limited to the practical effect of the tax on interstate commerce, regardless of the inherently local nature of the activity.

The clarification was necessitated by the narrower definition of interstate commerce the Court had previously applied to dormant Commerce Clause cases prior to its landmark decision in *Complete Auto, supra. See, Katzenbach, supra, 379 U.S.*, at 302 (noting the double standard that applied between the two lines of cases). Prior to *Complete Auto,* the Court had interpreted the scope of interstate commerce more narrowly in its tax cases to avoid striking down state taxes under the formalistic approach in effect at that time. *See Commonwealth Edison v. Montana,* 453 U.S. 609, 617, 625 (1981) (where the Court rejected a formalistic definition of commerce in favor of a practical effects-oriented economic analysis). The Court's statement in *Camps Newfound* reiterated that the same practical approach to discrimination applied under its dormant Commerce Clause tax jurisprudence to dispel any notion that a property tax that operated to discriminate against the flow of services across state lines could serve as a loophole under that line of cases.

The *Camps Newfound* majority made it clear, however, that it did not extend the scope of the dormant

Commerce Clause beyond tariff-like measures, holding that Maine's credit: "functionally serves as an export tariff that targets out-of-state consumers by taxing the businesses that principally serve them." *Camps Newfound*, at 580-581.

In sum, Ohio's investment tax credit does not violate the dormant Commerce Clause because it is not a tariff-like measure. Therefore, it is wholly unnecessary to justify the investment tax credit as a "subsidy." *Cuno*, at 746. It is, however, a worthwhile exercise to briefly note the similarity between Ohio's investment tax credit and a direct subsidy under the Court's dormant Commerce Clause jurisprudence. The Court described the standard for concluding a measure is a direct subsidy in *New Energy*, *supra*, 486 U.S. 269, at 278:

> The Commerce Clause does not prohibit all state action designed to give its residents an advantage in the marketplace, but only action of that description *in connection with the state's regulation of interstate commerce*. Direct subsidization of domestic industry does not ordinarily run afoul of that prohibition; discriminatory taxation of out-of-state manufacturers does. [Emphasis supplied.]

In *New Energy*, it was clear that the meaning the Court assigned to the "regulation of interstate commerce" was the flow of commerce across state lines, in that case, the importation of out-of-state produced ethanol. It would have been inconsistent with its prior jurisprudence for the Court to have expanded the scope of the dormant Commerce Clause beyond tariff-like measures, and there is no indication that it intended to do so by the explicit language it carefully employed in *New Energy*. Therefore, although it is unnecessary to justify Ohio's investment tax credit as a "direct subsidy," both are supported by the same analytical framework in the sense that neither are tariffs

falling astray of the narrow scope of the Court's authority under the dormant Commerce Clause.

B. A taxpayer that invests in property located in Ohio is not similarly situated, under Ohio's franchise tax, to a taxpayer that invests in property located outside of Ohio. The Sixth Circuit erroneously assumed that such a taxpayer increases its tax burden and, therefore, erroneously found facial discrimination where none was present.

The Sixth Circuit invalidated Ohio's investment tax credit, erroneously concluding that (*Cuno*, at 743):

> [A]ny corporation currently doing business in Ohio, and therefore, paying the state's corporate franchise tax in Ohio, can reduce its existing tax liability by locating significant new machinery and equipment within the state, but it will receive no such reduction in tax liability if it locates a comparable plant and equipment elsewhere.

The Sixth Circuit, however, failed to take into account Ohio's franchise tax scheme in its entirety. Ohio employs a three-factor apportionment formula consisting of the average of the ratios of a taxpayer's Ohio property divided by its total property everywhere, its Ohio payroll divided by its total payroll everywhere, and its Ohio sales divided by its total sales everywhere. Ohio Rev. Code section 5733.05(B)(2). Ohio's is the standard three-factor formula adopted by many states. Pomp and Oldman, State and Local Taxation (4th Ed. 2000), at pp. 10-12.

A corporate taxpayer that invests in property located in Ohio increases the ratio of its Ohio property to its everywhere property and, thus, increases its taxable presence in Ohio. The increased apportionment percentage is applied to the taxpayer's worldwide income derived from

its unitary business. *See, e.g., Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983) (upholding a state's authority to apportion a corporate taxpayer's income derived from its worldwide unitary business). Thus, the more extensive a taxpayer's worldwide operations constituting its unitary business, the greater the income derived from those worldwide activities, the greater the tax effect that results from an increase to the taxpayer's worldwide apportionment ratio.[1] The Sixth Circuit erroneously assumed that a taxpayer who invests in Ohio property would reduce its tax liability, limiting its inquiry to the investment tax credit and, thus, ignoring the tax increase under Ohio's property factor from investing in that property.

Similarly, a taxpayer that invests in property outside of Ohio does not, as the Sixth Circuit erroneously assumed, "receive no ... reduction in tax liability." *Cuno*, at 743. Rather, an investment in property located outside Ohio increases the denominator of the property factor without any decrease to the numerator.[2] It, therefore, decreases the property factor and the taxpayer's taxable presence in Ohio. The Sixth Circuit clearly fails to take into account the effect of the property investment on the taxpayer's apportionment of its worldwide income, even though it can be quite significant depending upon the taxpayer's pre-apportionment worldwide income base.

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[1] For example, in *Container, supra*, at 174-175, the net effect of including the taxpayer's income derived from its worldwide operations in the tax base was to increase its tax liability, even though its worldwide apportionment percentage decreased. Each percentage point of the taxpayer's reduced apportionment percentage, thus, had a proportionately greater tax effect when applied to the increased worldwide tax base.

[2] *Id.*

Under Ohio's apportionment scheme, a taxpayer that invests in property located outside of Ohio and, thus, decreases its property factor and base taxable income figure, is not similarly situated to a taxpayer that invests in property located in Ohio and, by doing so, increases its property factor and base taxable income figure.[3] A state tax discriminates against interstate commerce only where two taxpayers are otherwise similarly situated in relation to the taxing statute, *Westinghouse, supra,* at 400, a standard the Sixth Circuit expressly noted when it compared "two businesses, otherwise similarly situated ..." *Cuno,* at 743. There is nothing in the Sixth Circuit's opinion to suggest that it considered the totality of Ohio's franchise tax scheme when evaluating the tax consequences under its dormant Commerce Clause discrimination analysis. Its analysis strongly suggests that it failed to take into account the effect of the property factor in determining the net effect of an investment in property within and without the state.

The Sixth Circuit's failure to consider Ohio's franchise tax computation in its entirety, and limit its inquiry only to one isolated step in that computation was reversible error, violating the "cardinal rule that a statute is to be read as a whole." *Wash. State Dep't of Soc. & Health Services v. Guardianship Estate of Keffler,* 537 U.S. 371, 385 (2003). The effect of Ohio's investment tax credit should not have been removed from its proper context, the entire tax computation, inclusive of the apportionment factors, of which it is an inseparable part. *McCarthy v. Bronson,* 500 U.S. 136, 139 (1991) (statutory language

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[3] *Id.* In determining whether an apportioned income tax discriminates against interstate commerce, the relevant figure is the taxpayer's "base taxable income," which is the taxpayer's income apportioned to the taxing jurisdiction by applying the taxpayer's three-factor apportionment percentage. *Westinghouse, supra,* at 400.

must be read in its proper context and not viewed in isolation). *See also, Westinghouse Electric, supra,* 466 U.S., at 400 (where the Court considered New York's export credit and apportionment scheme in its entirety).

Each taxpayer has its own individual tax profile, varying in the scope and extent of its worldwide unitary business, the amount of the net income derived from that unitary business, and the relationship of that income to its worldwide apportionment factors. The Sixth Circuit's failure to consider the overall effect of investing in Ohio property on each of those components of Ohio's franchise tax computation made it impossible for that court to conclude that each taxpayer's investment tax credit would always exceed the incremental tax from increasing its Ohio property factor, regardless of the taxpayer's worldwide income.

Respondents, moreover, bear a heavy burden to show facial discrimination, even under the Sixth Circuit's erroneous standard comparing the tax consequences of the credit for an individual taxpayer. *See United States v. Salerno,* 481 U.S. 739, 745 (1987) (taxpayer must establish that no set of circumstances exist under which the Act might be valid). Respondents have failed to show that all taxpayers who invest in the same dollar amount of property within Ohio would experience a net tax decrease of their Ohio franchise tax liability as compared with the same dollar investments in property located outside of Ohio.

Note that the above analysis does not depend upon whether a state employs the standard three-factor formula or a single-factor sales formula. The dollar amount of property a taxpayer employs in its business is a proxy for a taxpayer's capital intensive activities, such as manufacturing, only where the state's legislature chooses such an apportionment scheme. Unlike a taxpayer's wages and sales which, standing alone, reflect a specific business operation or activity (i.e., services performed or sales), a taxpayer's investment in property in a particular location

does not inherently locate an activity except by proxy. Where a state employs a single-factor sales formula, the state's legislature did not choose to treat a property investment as a proxy for business activity. Two taxpayers are, thus, similarly situated under a single-factor sales formula where both sell within the state or where both sell outside of the state. Where an investment tax credit is denied under such a scheme for the sole reason the property investment is located outside the state, such denial is completely unrelated to whether the goods are sold within or without the taxing state. A credit discriminates against interstate commerce under a single factor sales formula only where there is a necessary connection between the credit and the point of sale, a connection that, if present, would render the credit either an import or an export tariff.

CONCLUSION

II. SINCE OHIO'S INVESTMENT TAX CREDIT DOES NOT ERECT A BARRIER TO INTERSTATE TRADE IT DOES NOT OFFEND THE DORMANT COMMERCE CLAUSE, AND THIS COURT SHOULD REVERSE THE SIXTH CIRCUIT'S DECISION UNDER ITS DORMANT COMMERCE CLAUSE CASE LAW.

Respectfully submitted,

MICHAEL A. CARDOZO,
Corporation Counsel of the
City of New York,
100 Church Street,
New York, New York 10007.
(212) 788-0848

LEONARD J. KOERNER,*
VINCENT D'ORAZIO,
ROBERT J. FIRESTONE,
of Counsel.

**Counsel of Record*